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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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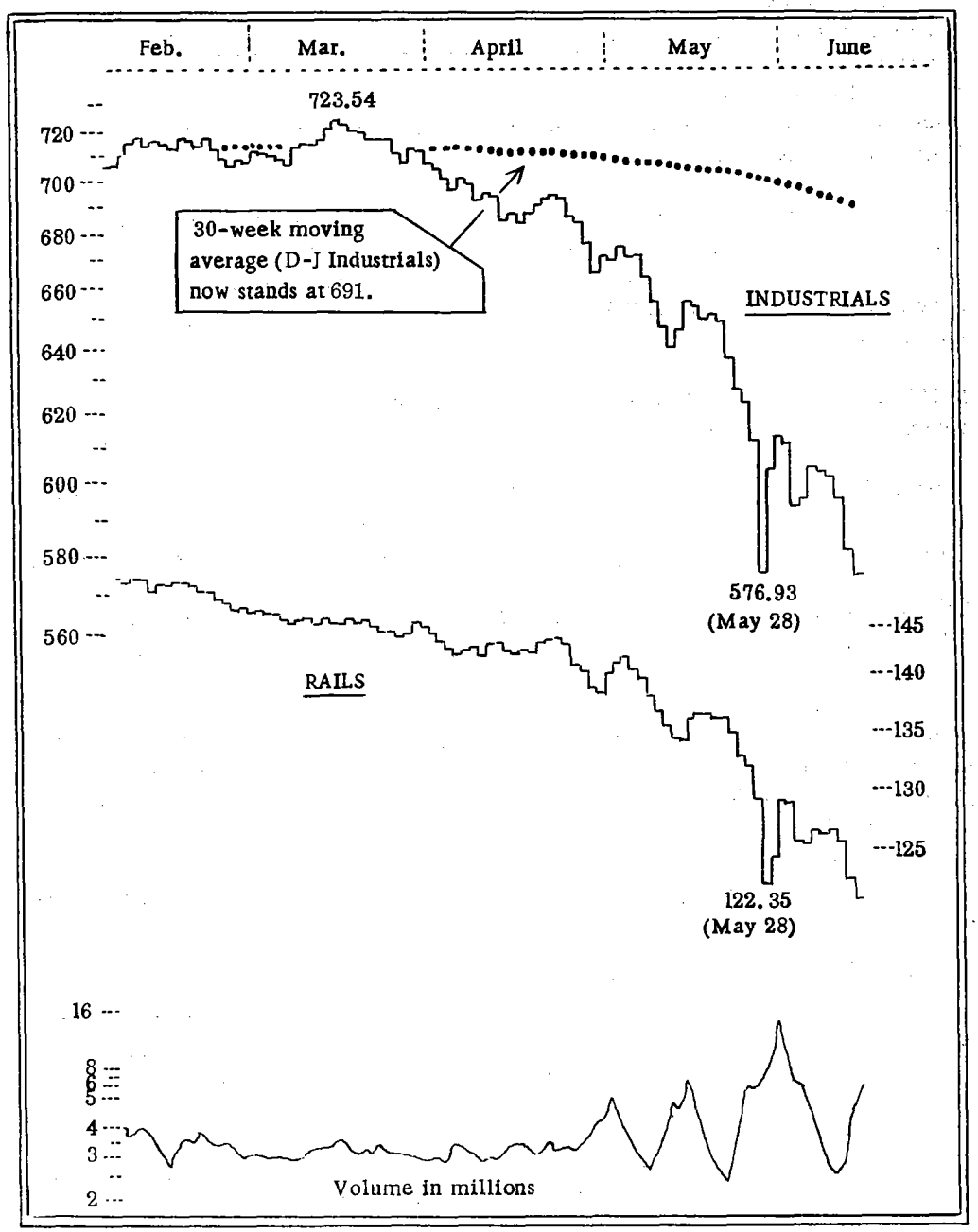
THE MARKET Recent Letters have urged subscribers not to attempt to "outguess" a primary swing in a bear market (neither the duration nor extent of a primary swing can be predicted in advance). Despite this, I have received dozens of notes and calls, the constant question being, "Should I buy now?" In general, I do not believe that the average investor can come out ahead with "scalping operations" during a bear market. Some floortraders and a few experienced tape-readers seem to possess the necessary "guts" and know-how, but I have never been convinced that the average student has the acumen (or luck) to beat the primary trend.

Robert Rhea was somewhat inconsistent about operating counter to the primary direction. Thus, during the collapse of 1937 he warned his readers almost weekly to stay on the sidelines. "A bear market is a good time for a vacation," he wrote, "and I am taking one."

On the other hand, in his book ("The Dow Theory") he writes: "Quiet, weak spots in a bear market are generally good ones to short, as they generally develop into serious declines. However, after a market has drastically declined, following such a manifestation, and then goes into a semi-panic collapse, it is wise to cover short positions and even perhaps make commitments for long accounts."

Because there are subscribers who are willing to assume speculative long positions when the turn comes, I will definitely state in these Letters when I think the time has come to "play the upward correction." It is well to remember that the greater the decline, the greater the eventual correction, (and of course, the greater the correction the better the opportunity for limiting losses and establishing gains).

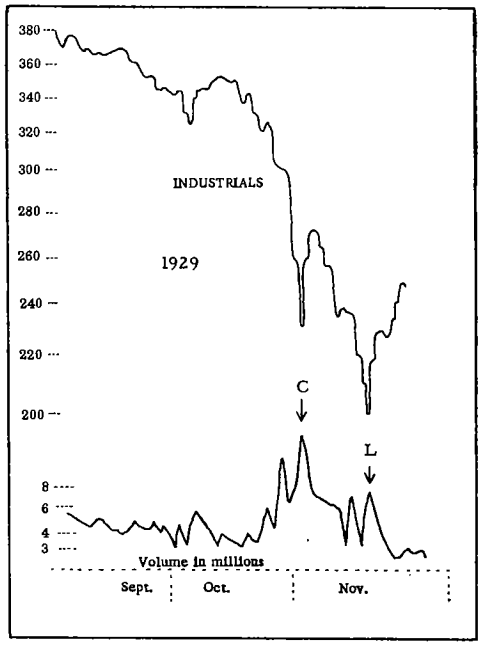
As this is written (Wed. April 13, 11 A.M. New York time) the tape is late with Industrials

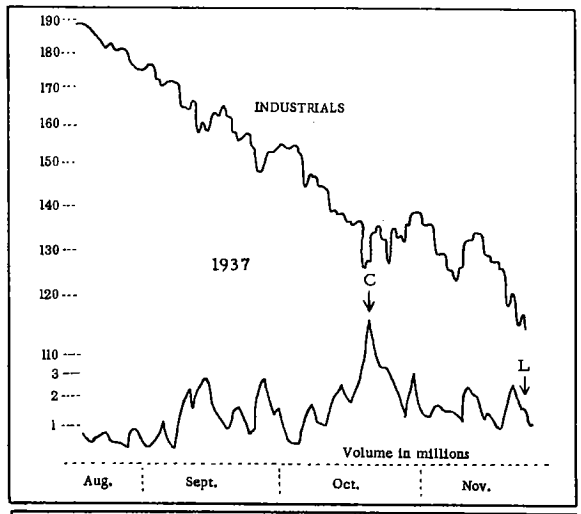


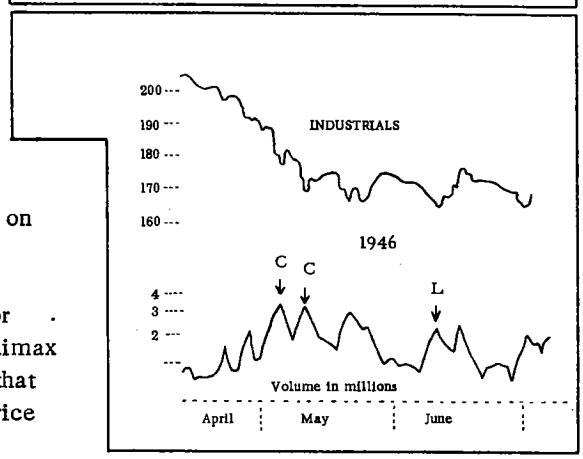
holding a few points above the May 28 low. The situation could not be more inconclusive, and for this reason I will hold my discussion of the price movement until the end of this Letter.

A HISTORY OF CRASHES

Letter 183 described the conditions which usually prevail around the termination of bear legs. The high volume which accompanied the lows of May 28, and the tremendous one-day reversal of May 29 were looked upon with suspicion. Moreover, I outlined the events which ended the great second downward bear leg of 1929, and the attention of readers was directed to the fact that the 1929 crash did not end on huge volume as is generally supposed.







The chart at right shows the action which accompanied the panic-declines or crashes of 1929, 1937, and 1946. The "C" on chart signifies the volume climax or climaxes, while the "L" identifies the final low of each bear leg. Note that in no case did the high volume (C) mark the termination of the downward price movement.

In 1929 and 1937, the final low (L) arrived a considerable distance below the volume climax (C). In 1946 the final low arrived only a few points below the volume climax.

Neither 1937 nor 1946 was followed by profitable advance, and in both cases the market dropped to or below the lows pictured on the chart within a matter of months. Following 1929 (the worst collapse in history), a great rally ensued which carried into April of 1930. The 1929-30 rally retraced 61.9% of the 1929 Industrial losses.

Whether the current collapse will be followed by a correction along 1937 or 1929 lines cannot, of course, be known. This writer suspects, however, that the final correction will be of the larger and more sustained variety.

It is worth remembering that during the huge 1929-30 retracement, psychology did a complete and unexpected turn-about. Thus Rhea writes of 1930: "I can remember having shorted stocks in early December, 1929, after having completed a satisfactory short position in October. When the slow but steady advance of January and February (1930) carried above previous intermediate highs, I became panicky and covered at considerable loss. With losses piling up every day, I forgot that the rally might normally be expected to retrace possibly 66% or more of the 1929 downswing. Nearly everyone was proclaiming a new bull market. Services were extremely bullish, and the upside volume was running higher than at the peak in 1929." It will pay every subscriber to remember this little paragraph when the turn comes.

"READJUSTMENT"? Never during the years that I have watched the stock market have I seen so many "authorities" ready to write off the implications of the Averages. Business leaders, financial analysts, Governmental spokesmen, the Secretary of the Treasury, and the President himself have announced that the nation is basically sound. Indeed, Mr. Kennedy has said that business is good, and that he feels that the market will straighten itself out and follow business to higher levels. If this is true, it will be one of those rare instances when the cart pulled the horse up the hill.

From all accounts, this is to be merely a painless readjustment in price-earnings ratios, brought on by nothing more than the retrospective fact that "prices were too high." Now that the Industrial Average is down around 160 points, we may rest secure in the knowledge that the market is once again on "more solid footing."

Many "barometers" that worked rather well in the past somehow failed to catch the decline of the last six months. Indeed,

some of these barometers are still bullish, and their adherents remain firm in their insistence that this is not a bear market. Call it what you will, thousands of investors have already lost 20 to 50% of their capital. As they say on Wall Street, "Everything is bullish but the prices."

Some of the investment services are insisting that the market is "wrong" and that "hysterical selling" has temporarily caused the Averages to "take leave of their senses." One well-known investment advisor (who should know better) even stated that the recent downside action was "ridiculous". Many years ago William P. Hamilton wrote: "In the mind of the demagogue, Wall Street can never be forgiven for being right when he is wrong."

Market systems come, and market systems go, but the only system which has lasted through the years is that method of analysis based on the movements of prices themselves (Dow's Theory). Each new bull market seems to produce its own "Blast Furnace Index", its "Wave Theory" or its "Formula Plan", but the final outcome has always been the same. The market goes down, and (as an old student, A. M. Shumate, recently put it),"Dow's Theory rises again."

WHAT'S AHEAD In the past, when structures such as the current one have appeared in the Averages, the market has been calling attention to trouble ahead. When a ship's barometer drops, the forecast may be for a hurricane or a strong wind, but the experienced captain learns to prepare for the worst (while hoping for the best). The "storm flags" are now flying, and this writer has repeatedly urged his readers to "batten the hatches" and prepare for whatever trouble may lie ahead.

Humphry Neill (of "Contrary Opinion" fame) has been writing of the possibility of a climax to the arms build-up. In his opinion, the current national problem may be one of getting off the armaments merry-go-round. In view of the recent well-publicized economic problems of the communist bloc, there would seem to be a real chance of an eventual (sincere) "peace drive" from the Red nations.

Our President, having run his campaign on the "balance the budget" ticket, has now done a complete (and not unexpected) about-face and has come up with that old "New Deal" solution, the deficit jag. Cut taxes, raise spending, keep money available and hold interest rates low; it's all so simple. But in his effort to emulate Franklin Roosevelt, our President has overlooked the fact that Mr. Roosevelt had a relatively large hoard of gold to work with -- as well as a comparitively small national debt. The "soup" was still pretty thick when F. D. R. added the water, but Mr. Kennedy is adding water to a mixture which had already begun to look more like broth than minestrone.

The gold problem has been discussed at such length here and in other publications that it is not worth a long analysis at this time. Perhaps the final word on the subject is being spoken by the market itself. Last week the gold stocks surged upward with such issues as Dome and Homestake making highs that have not been witnessed since the '40's. This generation has never seen (and in most cases never read about) an old fashioned gold crisis. It is possible that our education is about to begin.

FACTS AND FANCIES At and around the lows of May, a great deal of publicity was released regarding the stalwart performance of the mutual funds. The New York Times (June 3) went so far as to title one of its articles, "Institutional Investors Praised for Role in Ending the Decline." That article went on to say that the funds had played a major part in turning the market at a time when disaster seemed imminent. "Let's face it," the president of one fund was quoted as saying, "the mutual funds acted like real pros. They saw their opportunities, they stepped in and took every advantage for their shareholders. The interesting thing is the way the shareholders endorsed this action. They showed no loss of confidence in us; in fact, they came in and bought more fund shares."

Of course, the fact that the public continued to buy heavily into the funds (if we use the odd-lot theory) can hardly be construed as bullish. Moreover, it occurs to me that if the fund holders retained their confidence in the funds, they must be using blind intuition -- not my statistics.

The actual figures on the fund performances are most enlightening. I have listed six leading mutual (stock) funds and their percentage of decline from December 13, 1961 (Dow 734.91) to May 28, 1962 (Dow 576.93). These performances may be compared to the drop of approximately 21.5% in the Dow Industrial Average over the same period.

Affiliated Fund	off 21.7%	Fundamental Investors	off 23.8%
Dividend Shares	off 21.9	Mass. Inv. Trust	off 26.2
Fidelity Fund	off 22.6	Mass. Inv. Growth Fund	off 28.5

Average loss for the six funds 24.1%

 As any investor will tell you, a loss of one quarter of your capital in five months is no laughing matter. Yet this is exactly what occurred (on average) in the six funds.

LATE NOTES: The market (Wednesday, June 13) attempted to mount a rally this morning. To the tune of a thirteen minute late tape, Industrials struggled up two points; then in the course of the noon hour the "rally" died. Selling came in during the afternoon and the market closed with both Averages at new bear market lows on a six minute late tape.

The simultaneous downside penetration was accomplished on expanding volume of 5.8 million shares, and this action put Industrials at 574.04, Rails at 121.27. Thus, (1) Industrials, Rails, and the advance-decline ratio have all broken to new low ground for the move, (2) the second leg of the bear market continues in effect, (3) the bear market has been reconfirmed.

Referring to penetrations Rhea wrote: "It is known that penetration accomplished with velocity and increasing activity is a more potent indication than when the signal is otherwise given. Again -- simultaneous penetration is conceded more authority than when the barriers are cleared with one Average delaying confirmation."

The closing of June 13 would seem to confirm to Rhea's definition of a completely authoritative penetration. This writer has absolutely no preconceived notion as to where or when the (current) second leg of the bear will terminate. I suggest, however, that readers review the section on Dow's 50% Principle as outlined in Letter 183 (page 2).

STOCKS The total stock picture continues the same in that only two out of our fifty-sx "key" stocks are now holding above their 10-week moving average. These are the golds, Campbell Red Lake and Dome Mines.

I have included "point-and-figure" charts of Dome Mines and Homestake Mining, one a Canadian and one an American gold producer. These are two of the strongest stocks on the board and both are in position for buying.

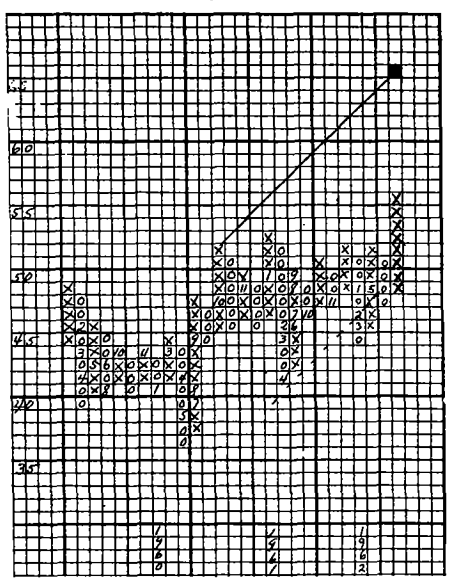
I find point-and-figure charts to be extremely helpful, particularly since this method compresses a good deal of action into a small area. Actually, price makes movement, not time. P & F charts eliminate time completely and record only price changes. These charts are 3-point reversal charts. Each time a stock rises (X's on chart) or declines (O's on chart) three points or more, a new vertical line is drawn -- with each individual box representing one point. Thus if a stock holds within a range of two points for two years, nothing will appear on the chart during that time. But if the stock fluctuates wildly during a period of a week, perhaps five vertical lines may be drawn.

Dome Mines is the only stock on the Board which has held above its long-term trendline since 1958. The P & F chart shows DM breaking above a quadruple top and giving a buy signal at 29. Homestake, while unable to hold above its long-term trendline, has nevertheless given a buy signal at 53 (breaking two previous tops) and again at 55 (bettering all preceding tops).

According to this method of P & F charting, the minimum upside objective can be seen by drawing a line at a 45 degree angle from the left side of the formation which produced the breakout, to the vertical line which produced the breakout. The solid black squares identify the upside objective on Dome as 40, and the upside objective on Homestake as 66. In primary movements, upside objective are often surpassed.

Charts courtesy of Chartcraft, Inc. Larchmont, N. Y.

HOMESTAKE MINING (HM)



DOME MINES, LTD. (DM)